Office-Supreme Court, U.S.
FILED
MAR 24 1983
STEVAS,
CLERK

No. 82-774

In the Supreme Court of the United States

OCTOBER TERM, 1982

PHILIP D. FARMAR AND MARIAN J. FARMAR, PETITIONERS

v.

UNITED STATES OF AMERICA

A. A. SUGG AND MARY A. SUGG, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

JOINT APPENDIX

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

MARVIN K. COLLIE
WILLIAM M. LINDEN
Vinson & Elkins
3400 First City Tower
Houston, Texas 77002
(713) 651-2400

JAMES A. CARTER
22 West Harris Avenue
San Angelo, Texas 76902

PETITION FOR A WRIT OF CERTIORARI FILED NOVEMBER 5, 1982
CERTIORARI GRANTED JANUARY 10, 1983

TABLE OF CONTENTS

	Page
Docket Entries—Philip D. and Marian J. Farmar ..	1
Docket Entries—A.A. and Mary S. Sugg	4
Stipulation	5
Joint Exhibit A—Oil and Gas Lease	13
Joint Exhibit B—Deferred Bonus Agreement	33
Joint Exhibit C—Deferred Bonus Agreement	37
Joint Exhibit K—Production Ledger	42
Affidavit of Bob Bales	47
Affidavit of Jesse M. Chipman, III	49
Affidavit of Don Dow	51
Order Granting Certiorari	53

RELEVANT DOCKET ENTRIES

Case No. 15-80 T

Date	Proceedings
Jan 9 1980	Filing fee of $10 paid by plaintiffs.
Jan 31 1980	Notice of reference to Trial Judge Mastin G. White filed. Copy to parties.
Mar 10 1980	Defendant's answer to the petition filed. Copies (5) to atty.
Mar 12 1980	Trial Judge's standard pretrial order on liability (Rule 111) filed. Copy to parties. [submission due: May 12 1980].
Apr 14 1980	Plaintiff's motion to extend time (to July 14, 1980) to comply with pretrial order filed. Copies (2) to deft. ALLOWED APR 28 1980.
Aug 7 1980	Plaintiffs' motion for consolidation of cases (this, and 16-80T) file Copies (2) to deft. ALLOWED: AUG 25 1980.
Sep 2 1980	Defendant's motion for extension of time (to Oct. 16, 1980) to comply with pretrial order filed in this, and 16-80. Copies (2) to atty. ALLOWED SEP 22 1980.
Jun 8 1981	Defendant's motion for summary judgment and brief filed. Copies (5) to atty.
Jun 8 1981	Exhibits to stipulation accompanying brief filed. Copy to atty.
Jun 8 1981	Defendant's motion for leave to file reduced number of copies of exhibits to the stipulation filed. Copies (2) to atty. ALLOWED: JUNE
Jun 23 1981	Plaintiffs' motion for extension of time (to August 7, 1981) to file reply to defendant's motion for summary judgment filed. Copies (2) to atty. [filed in this and 16-80T] ALLOWED: JUN 23 1981.
Aug 7 1981	Plaintiffs' cross-motion for summary judgment, and opposition to defendant's motion for summary judgment filed. Copies (5) to deft. [filed in this and 16-80 T]
Sept 8 1981	Defendant's motion for enlargement of time (to Oct 6 1981) to file its reply brief filed. Copies (2) to atty. [filed in this and 16-80 ALLOWED: SEP 11 1981.

Date	Proceedings
Oct 6 1981	Defendant's reply brief in support of its motion for summary judgment and brief in opposition to plaintiffs' cross-motion for summary judgment filed [in this and in 16-80 T]. Copies (5) to atty.
Oct 29 1981	Plaintiffs' motion for extension of time (to December 7, 1981) to file its reply brief filed [in this and 16-80T]. Copies (2) to deft. ALLOWED: OCT 30 1981.
Nov 25 1981	Plaintiffs' reply brief in support of their cross-motion for summary judgment filed [in this and 16-80T]. Copies (5) to deft.
Jan 11 1982	Plaintiffs' motion for leave to file supplemental brief filed (in this and 16-80T). Copies (2) to deft. ALLOWED: JAN 20, 1982, with defendant granted 20 days within which to file a responding supplemental brief.
Jan 19 1982	Defendant's reply to plaintiffs' motion for leave to file supplemental brief filed [in this and 16-80T]. Copies (2) to atty.
Jan 20 1982	Plaintiffs' supplemental brief in support of their cross-motion for summary judgment and in opposition to defendant's motion for summary judgment filed. Copies (5) to deft.
Feb 1 1982	Defendant's response to plaintiffs' supplemental brief filed. Copies (5) to atty.
Apr 7 1982	Argued and submitted on defendant's motion for summary judgment and plaintiff's cross-motion for summary judgment. [Before Davis Cowen and Nichols]. Defendant to furnish copies of referred to U.S. Tax Court decision. [In this and 16-80T]
May 14 1982	Defendant's motion for leave to file an appellate opinion and to submit a supplemental memorandum filed. Copies (2) to atty. [by June 15, 1982] ALLOWED: MAY 17 1982, with plaintiff granted 10 days from receipt of defendant's memo within which to respond
May 17 1982	Opinion of the Court of Appeals in ***Engle v. Commissioner***, filed. Parties notified.
Jun 15 1982	Defendant's supplemental memorandum filed. Copies (5) to atty.

Date	Proceedings
Jun 21 1982	Defendant's motion for leave to file correction to the supplement memorandum filed Jun 15 1982 filed. Copies (2) to atty. [In this and 16-80 T] ALLOWED: Jun 25 1982
Jun 24 1982	Plaintiffs' answer to the supplemental memorandum for deft. filed. Copies (5) to deft.
Jun 25 1982	Defendant's correction to supplemental memorandum filed. Copies (2) to atty.
Jun 28 1982	Plaintiffs' motion for leave to file an answer to defendant's correction of its supplemental memorandum filed. Copies (2) to deft. ALLOWED: JUN 30 1982.
Jun 30 1982	Plaintiffs' answer to defendant's correction of its supplemental memorandum filed. Copies (2) to deft.
Sep 22 1982	In this and 16-80T, petitions dismissed. Opinion by Judge Davis. Copies to parties.

RELEVANT DOCKET ENTRIES

Case No. 16-80 T

Date	Proceedings
Jan 10 1980	Filing fee of $10 paid by plaintiffs.
Jan 31 1980	Notice of reference to Trial Judge Mastin G. White filed. Copy to parties.
Mar 10 1980	Defendant's answer to the petition filed. Copies (5) to atty.
Mar 12 1980	Trial Judge's standard pretrial order on liability (Rule 111) filed. Copy to parties. [submission due: May 12, 1980].
Apr 15 1980	Plaintiff's motion to extend time (to July 14, 1980) to comply with pretrial order filed. Copies (2) to deft. ALLOWED APR 28 1980.
Aug 7 1980	See plaintiff's motion in 15-80 T to consolidate.
Aug 25 1980	SEE 15-80 T FOR FURTHER PROCEEDINGS.

IN THE UNITED STATES COURT OF CLAIMS

No. 15-80 T

PHILIP D. FARMAR AND MARIAN J. FARMAR, PLAINTIFFS

v.

THE UNITED STATES, DEFENDANT

No. 16-80 T

A. A. SUGG AND MARY S. SUGG, PLAINTIFFS

v.

THE UNITED STATES, DEFENDANT

STIPULATION

It is hereby stipulated by and between the parties hereto, by their respective counsel, for the purpose of these cases only, that the following statements are true and correct and may be accepted as facts, that all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof, and that these exhibits are true and correct copies.

1. Plaintiffs Philip D. Farmar and Marian J. Farmar reside at 1410 Warwick Lane, Newport Beach, California 92660.

2. Plaintiffs A. A. Sugg and Mary S. Sugg reside in San Angelo, Texas, and have a mailing address of Post Office Box 573, San Angelo, Texas 76902.

3. Plaintiffs engage in various activities, including oil or gas leasing and development as mineral owners.

4. Plaintiffs are not excluded refiners nor excluded retailers but are independent producers or royalty owners within the meaning of those terms in Section 613A.

5. Plaintiff A. A. Sugg owns an undivided 50.52-percent interest in a mineral estate of approximately 46,514.65

acres of land located in Irion County, Texas (hereinafter the "Irion Property").

6. By lease dated December 1, 1975, plaintiff A. A. Sugg executed an oil and gas lease for a term of five years, leasing his ownership of 23,500.97 undivided mineral acres under the Irion Property to Allied Chemical Corporation and Florida Gas Exploration Company.

7. Pursuant to the December 1, 1975, lease agreement for the Irion Property, plaintiff A. A. Sugg reserved the right to receive as royalties the following:

> (a) Twenty (20) percent or one-fifth (1/5) of all oil and gas produced and sold from the property, or
>
> (b) Twenty (20) percent or one-fifth (1/5) equal part of the value of all oil and gas produced and saved from the leased premises.

This fractional royalty represents the mineral owner's share of the oil and gas produced from his property.

8. On December 12, 1975, plaintiff A. A. Sugg executed a Deferred Bonus Agreement with Allied Chemical Corporation and Florida Gas Exploration Company for the Irion Property. Pursuant to this agreement, plaintiff A. A. Sugg was entitled to receive a bonus in the amount of $1,057,543.60, computed at the rate of $45 per mineral acre, for the execution and delivery of the December 1, 1975, lease agreement for the Irion Property.

9. The amount of $1,057,543.60, to which plaintiff A. A. Sugg was entitled under the terms of this December 12, 1975, Deferred Bonus Agreement for the Irion Property, was payable in three installments, as follows:

On or before December 25, 1975	$ 1,000.00
Between January 10 and January 20, 1976	528,271.00
Between January 10 and January 20, 1978	528,271.00
	$1,057,543.60

10. The amount of $1,057,543.60, to which plaintiff A. A. Sugg was entitled under the December 12, 1975, Deferred Bonus Agreement, was payable regardless of whether production of oil or gas commenced pursuant to the lease agreement described in paragraphs 7(a) and 7(b) above and does not affect the fractional amounts to which plaintiff

A. A. Sugg is entitled, if any, after execution of the lease agreement.

11. Pursuant to the December 12, 1975, Deferred Bonus Agreement, plaintiff A. A. Sugg received a payment of $528,271.80 in January 1976. This amount was reported as "oil and gas bonus" income in plaintiffs' 1976 joint income tax return. Plaintiffs A. A. Sugg and Mary S. Sugg claimed a 22-percent depletion allowance on $528,271.80, plus other oil and gas bonuses of $86,400.00, in the amount of $135,227.80, on their 1976 joint income tax return.

12. As a result of an Internal Revenue Service examination of plaintiffs A. A. Sugg and Mary S. Sugg's federal income tax return for the calendar year 1976, on February 10, 1978, the Internal Revenue Service assessed a deficiency in federal income taxes against them in the amount of $95,141.60, plus interest in the amount of $5,981.54 for the calendar year 1976.

13. On April 7, 1978, plaintiffs A. A. Sugg and Mary S. Sugg paid the asserted total deficiency of $95,141.60, plus assessed interest of $5,981.54.

14. On October 5, 1978, plaintiffs A. A. Sugg and Mary S. Sugg timely filed Form 1040X, Amended U.S. Individual Income Tax Return, with the District Director of Internal Revenue, Dallas, Texas, claiming a refund of $95,141.60 for the calendar year 1976. This claim for refund states that an adjustment for statutory depletion of Schedule E should be made with respect to the "lease bonus" of $614,671.80 to permit a percentage depletion deduction of 22 percent.

15. On August 22, 1979, the District Director of Internal Revenue, Dallas, Texas, mailed to plaintiffs A. A. Sugg and Mary S. Sugg a denial of their claim for refund for the calendar year 1976 by certified mail, whereupon these plaintiffs filed a petition that is the subject of this suit.

16. Plaintiff Philip D. Farmar and his four children own an undivided 49.48-percent interest in a mineral estate of approximately 46,514.65 acres of land located in Irion County, Texas (hereinafter the "Irion Property").

17. Plaintiff Philip D. Farmar owns approximately 79.63 percent of the 49.48 percent undivided interest in the Irion Property, or 18,326.78 undivided mineral acres.

18. For the year 1976, plaintiff Philip D. Farmar and his four children filed Form 1065, United States Partnership Tax Return, with respect to the income, deductions, and credits associated with their joint ownership interests in the Irion Property.

19. On December 1, 1975, plaintiff Philip D. Farmar executed a lease for a term of five years, leasing his ownership of 18,326.78 undivided mineral acres under the Irion Property to Allied Chemical Corporation and Florida Gas Exploration Company.

20. Pursuant to the December 1, 1975, lease agreement for the Irion Property, plaintiff Philip D. Farmar reserved the right to receive as royalties the following:

> (a) Twenty (20) percent or one-fifth (1/5) of all oil and gas produced and sold from the property, or
>
> (b) Twenty (20) percent or one-fifth (1/5) equal part of the value of all oil and gas produced and saved from the leased premises.

This fractional royalty represents the mineral owner's share of the oil and gas produced on his property.

21. On December 12, 1975, plaintiff Philip D. Farmar executed a Deferred Bonus Agreement with Allied Chemical Corporation and Florida Gas Exploration Company for the Irion Property. Pursuant to this agreement, plaintiff Philip D. Farmar was entitled to receive a portion of $824,703.44, from the total amount of $1,035,615.60 due to the partnership, computed at the rate of $45 per mineral acre, for the execution and delivery of the December 1, 1975, lease agreement for the Irion Property.

22. The amount of $1,035,615.60, to which plaintiff Philip D. Farmar and his four children were entitled under the terms of this December 12, 1975, Deferred Bonus Agreement for the Irion Property, was payable in five installments, as follows:

On or before December 25, 1975	$ 5,000.00
Between January 10 and January 20, 1976	257,653.90
Between January 10 and January 20, 1977	257,653.90
Between January 10 and January 20, 1978	257,653.90
Between January 10 and January 20, 1979	257,653.90
	$1,035,615.60

23. The amount of $1,035,615.60, to which plaintiff Philip D. Farmar and his four children were entitled under the December 12, 1975, Deferred Bonus Agreement, was payable regardless of whether production of oil or gas commenced pursuant to the lease agreement described in paragraphs 20(a) and 20(b) above and does not affect the fractional amounts to which plaintiff is entitled, if any, after execution of the lease agreement.

24. Pursuant to the December 12, 1975, Deferred Bonus Agreement, plaintiff Philip D. Farmar and his four children received a payment of $257,653.90 in January 1976. This amount was reported on an attachment to the Form 1065, United States Partnership Tax Return, for 1976 as "oil and gas bonus" income.

25. Plaintiff Philip D. Farmar's portion of the amount received in January 1976, pursuant to the December 12, 1975, Deferred Bonus Agreement, was $205,180.86. This amount was reported as income in plaintiffs Philip D. Farmar and Marian J. Farmar's 1976 joint income tax return. As described in an attachment to Schedule E, Part III, of plaintiffs Philip D. Farmar and Marian J. Farmar's 1976 return, their share of the partnership income was $268,975.83 (which includes the $205,180.86 amount received under the Deferred Bonus Agreement for the Irion Property), from which was deducted $5,867.64 representing "Tentative Allowable Statutory Depletion—Royalty;" $45,139.79 representing "Tentative Allowable Statutory Depletion—Bonus;" and $925.79 representing "Expenses Incurred Relating to Partnership."

26. The "Tentative Allowance Statutory Depletion—Bonus" of $45,139.79, represents a 22-percent depletion allowance on the income of $205,180.86 received pursuant to the December 12, 1975, Deferred Bonus Agreement for the Irion Property.

27. As a result of an Internal Revenue Service examination of plaintiffs Philip D. Farmar and Marian J. Farmar's federal income tax return for the calendar year 1976, on August 7, 1978, the Internal Revenue Service assessed a deficiency in federal income taxes against them in the

amount of $23,350.62, plus interest in the amount of $1,720.75 for the calendar year 1976.

28. On August 20, 1978, plaintiffs Philip D. Farmar and Marian J. Farmar paid the asserted total deficiency of $23,350.62, plus assessed interest of $1,720.75.

29. On October 8, 1978, plaintiffs Philip D. Farmar and Marian J. Farmar timely filed Form 1040X, Amended U.S. Individual Income Tax Return, with the District Director of Internal Revenue, Dallas, Texas, claiming a refund of $23,350.62 for the calendar year 1976. This claim for refund states that an adjustment for statutory depletion on Schedule E should be made with respect to the "lease bonus" of $45,139.79 to permit a percentage depletion deduction of 22 percent.

30. On August 15, 1979, the District Director of Internal Revenue, Dallas, Texas, mailed to plaintiffs Philip D. Farmar and Marian J. Farmar a denial of their claim for refund for the calendar year 1976 by certified mail, whereupon these plaintiffs filed a petition that is the subject of this suit.

31. During 1976, the first year of the lease, oil and gas was discovered in the following wells on the Irion Property:

a. Union Texas Petroleum Corporation—Skelly-Sugg "45" in Section 45, Blk 1.

b. Union Texas Petroleum Corporation—No. 1 Sugg "3072" in Section 3072, Blk 1.

c. Union Texas Petroleum Corporation—Farmar "56" in Section 56, Blk 1.

d. Union Texas Petroleum Corporation—McAlester-Sugg "70" in Section 70, Blk 1.

e. Union Texas Petroleum Corporation—Farmar "52" in Section 52, Blk 1.

f. Union Texas Petroleum Corporation—Sugg "3" in Section 3, Blk 6.

During the first year of the lease herein, these six wells produced approximately 25,855 barrels of oil and approximately 13,498,000 cubic feet of gas.

32. If the leasees abandon the lease herein, the lessees are not entitled to a return of any sums paid pursuant to the deferred bonus agreements herein.

33. The amounts to which plaintiffs lessors are entitled under the deferred bonus agreements herein are assured payments and are not subject to alteration in the event the lessees extract a better (or lower) grade of oil or gas; or in the event the lessees drill dry holes and, therefore, are unable to extract any oil or gas.

34. Attached hereto as Joint Exhibit A is a true copy of the Oil and Gas Lease effective December 1, 1975, between Philip D. Farmar, Nancy Farmar Warfield, Andrea Farmar Bjeldanes, Peter D. Farmar, and Philip D. Farmar, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased, and Andrew A. Sugg, as lessors and Allied Chemical Corporation and Florida Gas Exploration Company, as lessees.

35. Attached hereto as Joint Exhibit B is a true copy of the Deferred Bonus Agreement dated December 12, 1975, between Andrew A. Sugg, as lessor, and Allied Chemical Corporation and Florida Exploration Company, as lessees.

36. Attached hereto as Joint Exhibit C is a true copy of the Deferred Bonus Agreement dated December 12, 1975, between Philip D. Farmar, Nancy Farmar Warfield, Andrea Farmar Bjeldanes, Peter D. Farmar, and Philip D. Farmar, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased, as lessors, and Allied Chemical Corporation and Florida Gas Exploration Company, as lessees.

37. Attached hereto as Joint Exhibit D is a true copy of the Form 1040, U.S. Individual Income Tax Return, for calendar year 1976, for A. A. Sugg and Mary S. Sugg.

38. Attached hereto as Joint Exhibit E is a true copy of the Form 1040X, Amended U.S. Individual Income Tax Return for calendar year 1976, for A. A. Sugg and Mary S. Sugg.

39. Attached hereto as Joint Exhibit F is a true copy of the letter from the District Director, Internal Revenue Service, Dallas, Texas, dated August 15, 1979, denying plaintiffs A. A. Sugg and Mary S. Sugg's claim for refund for calendar year 1976.

40. Attached hereto as Joint Exhibit G is a true copy of a 1976 Form 1040, U.S. Individual Income Tax Return, for Philip D. Farmar and Marian J. Farmar.

41. Attached hereto as Joint Exhibit H is a true copy of Form 1040X, Amended U.S. Individual Income Tax Return for calendar year 1976, for Philip D. Farmar and Marian J. Farmar.

42. Attached hereto as Joint Exhibit I is a true copy of a letter from the District Director, Internal Revenue Service, Dallas, Texas, dated August 15, 1979, denying plaintiffs Philip D. Farmar and Marian J. Farmar's claim for refund for calendar year 1976.

43. Attached hereto as Joint Exhibit J is a true copy of Form 1065, United States Partnership Tax Return, for calendar year 1976, for Philip D. Farmar and Nancy F. Warfield et al., Ptr., Philip D. Farmar Agency.

44. Attached hereto as Joint Exhibit K are certified copies of five (5) pages of the production ledger maintained by the office of the Texas Railroad Commission, Austin, Texas, containing 1976 oil and gas production amounts.

/s/ _____
JAMES A. CARTER
Attorney for Plaintiffs

/s/ _____
JOHN F. MURRAY
Acting Assistant Attorney General

/s/ _____
MAXINE C. CHAMPION
Attorneys for Defendant

JOINT EXHIBIT A

OIL AND GAS LEASE

AGREEMENT, made and entered into this 1st day of December, 1975, by and between ANDREW A. SUGG, herein called "Sugg"; and PHILIP D. FARMAR, NANCY FARMAR WARFIELD (formerly called Nancy Farmar), ANDREA FARMAR BJELDANES (formerly Andrea Farmar), PETER D. FARMAR and PHILIP D. FARMAR, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased, for the benefit of Steven S. Farmar, herein collectively called "Farmar", with all of the parties just named collectively hereinafter called Lessor, and ALLIED CHEMICAL CORPORATION, whose address is 1300 Wilco Building, Midland, Texas 79701, and FLORIDA GAS EXPLORATION COMPANY, whose address is 2240 The 1100 Milam Building, Houston, Texas 77002, herein collectively called Lessee.

WITNESSETH: That Lessor, for and in consideration of TEN DOLLARS ($10.00), cash in hand paid, and other good and valuable consideration, the receipt of which is hereby acknowledged, and of the covenants and agreements hereinafter contained on the part of Lessee to be paid, kept and performed, has granted, demised, leased and let, and by these presents does grant, lease and let exclusively unto Lessee for the sole and only purpose of prospecting and drilling for and producing and owning oil and gas, laying pipelines, injecting salt water produced from the premises, building tanks, power stations and other structures thereon to produce, save, care for, treat and transport said products of the lease, the following lands in Irion County, Texas, described in Exhibit A attached hereto and incorporated herein and containing 46,514.65 acres, more or less.

Subject to the other provisions herein contained, this lease shall remain in force for a term of five (5) years from this date (hereinafter called primary term) and subject to conditions herein contained, as long thereafter as oil and gas, or either of them is produced in paying quantities from

the lands hereby leased, or as long thereafter as operations are conducted as hereinafter provided.

In consideration of the premises, Lessee covenants and agrees:

1. To deliver to the credit of Lessor as royalty, free of cost, in the pipeline to which Lessee's wells may be connected, an equal twenty percent (20%) of all oil and gas produced and saved from said leased premises or at the option of Lessor, the same equal part of the value of all oil and gas produced and saved from said leased premises; provided, however, that if Lessor fails to take or dispose of Lessor's royalty oil and/or gas, Lessee shall have the right, for the time being and subject to revocation at Lessor's will, to sell Lessor's share of such oil and/or gas to others and Lessor's share shall be twenty percent (20%) of the total amount realized by Lessee from the sale of one hundred percent (100%) of the oil and/or gas sold from the premises.

2. If no well be commenced on said land on or before one (1) year from date hereof, this lease shall terminate as to both parties unless Lessee, on or before one (1) year from this date, shall pay or tender to Sugg an amount of money equal to One Dollar ($1.00) per acre or deposit such sum to the account of Andrew A. Sugg with The First National Bank of San Angelo, Texas, as a depository bank and to Farmar an amount of money equal to One Dollar ($1.00) per acre or deposit such amount with The Central National Bank of San Angelo, San Angelo, Texas, for deposit to the Philip D. Farmar agent, Account No. 204-424-2, which banks are hereby respectively designated as depository banks and their respective successors shall continue as a depository regardless of changes of ownership of said lands, which sum of money shall operate as rental and cover the privilege of deferring the commencement of a well for one (1) year from said date; provided, however, that the commencement of a well shall abate the necessity for the next annual payment or tender of delay rentals to perpetuate this lease only as to six hundred forty areas per well commenced. In each instances the sum of money to be paid or deposited in lieu of drilling shall be determined by multiplying the stated price per acre times the number of net

mineral acres owned respectively by Sugg and by Farmar and on which a well has not been commenced. In like manner and upon like payments or tenders, the commencement of drilling operations of a well may be further deferred for like periods of one (1) year each during the primary term hereof. A well shall not be considered to have been commenced unless the same is thereafter drilled with reasonable and continuous diligence. The drilling of a well, even if the same is a dry hole, shall abate the payment of delay rentals only as to six hundred forty (640) acres. For purposes of paying delay rentals the acreage shown opposite each tract of land in Exhibit "A" shall be conclusively presumed to be the number of acres contained in that particular tract.

3. Should the first well or subsequent successive wells drilled on the above described land be a dry hole or dry holes, this lease shall terminate as to both parties, unless, on or before the rental paying date next ensuing after the date of completion of such dry hole the Lessee commences the drilling of another well or resumes payment of annual delay rentals in the same manner as provided in Paragraph No. 2 of this lease. If at the expiration of the primary term or any other expiration of this lease, Lessee is then engaged in drilling operations, this lease shall remain in force as to the producing unit on which such well is situated so long as such operations continue thereon, and if such well results in production, then so long thereafter as oil or gas is produced from such producing unit, subject, however, to the depth limitations set out in Paragraph 20 of this lease.

4. Except for surface water or water from Lessor's water wells, Lessee shall have the right to use free of cost, gas, oil and water produced from said lands for all operations except that use of fresh water is limited to use of same for drilling operations. Any earthen pits shall be lined in such a manner as to prevent any substance placed therein from penetrating through such lining. At no time shall substantial quantities of salt water or other deleterious substances be stored or placed in surface pits, and all pits into which salt water or other deleterious substances is temporarily placed shall be constructed and sealed in a water-tight man-

ner so that the same cannot escape through or over such pits, and if substantial quantities of salt water are produced, the same shall be reinjected in a formation which is below all fresh water bearing formations, and in all events salt water and other deleterious substances shall be handled in such a manner so as not to pollute fresh water. When requested by Lessor, Lessee shall bury all pipelines when the ditch therefor can be dug with the use of a conventional ditching machine. Where such cannot be so accomplished, the pipe will be buried at all road, fence and livestock and/or game trail crossings and in all other areas the pipeline will be partially buried or at least covered to the extent that the pipe will not be exposed even though the same is lying on the surface, and to accomplish this, Lessee may grade up dirt adjacent to the pipeline so long as there is no substantial change of grade and erosion is not caused thereby. Lessee shall maintain such pipelines in order to prevent erosion or exposure thereof. No well shall be drilled nearer than one thousand three hundred twenty feet (1,320) to any house, barn, windmill, watering facility, pens, corrals or air strip now on said premises without the written consent of Lessor, and no well shall be drilled nearer than one-half (½) mile from the enclosure surrounding the OH Triangle Headquarters situated in the southeast corner of Survey 1894 E. Heinrich. Before a proposed well is commenced in either Survey 1983, D. Verbene; 1894, E. Heinrich; 1895, E. W. Weygand or 3067, Block 28, H&TC RR Co., Lessee and Lessor shall confer with a view toward establishing a development pattern for those surveys which is reasonably calculated to produce the least interference with Lessor's use and enjoyment of the OH Triangle Headquarters by avoiding as far as reasonably possible the drilling of well or wells within the prohibited distance.

5. All equipment, mobile or stationary, of every kind and character that will touch the ground, prior to entry on the premises, shall first be thoroughly washed and cleaned to the extent that such equipment is not reasonably susceptible of introducing bitterweed or other noxious weeds on the premises. By way of illustration but not limitation, such

equipment shall include dirt moving equipment, self-propelled well servicing units, sub-structures for drilling rigs, logging trucks, oil well cementing trucks and equipment, tractors and equipment carriers such as floats, trailers and all other dual wheel vehicles. If, notwithstanding these precautions, bitterweed or other noxious weeds should appear on or adjacent to any site of Lessee's operation, including roads used, then Lessee will take steps necessary to eliminate the bitterweed or other noxious weeds and for failure to perform this particular obligation, Lessee shall be liable for the reasonable cost of complying with the same. This provision is not intended to make Lessee an unlimited insurer against bitter or noxious weeds intrusion on Lessor's ranch but to the contrary is intended to be applicable to those situations where it is reasonably evident that such intrusion was caused or aggravated by Lessee's operation.

6. Prior to the commencement of any operations on the lease, Lessee shall confer with a representative of Lessor with a view toward agreeing upon suitable locations for drilling operations, access roads, tank batteries, metering stations, gathering and flow lines and the like. Such locations shall be in such positions as will cause the least interference with ranching operations, taking into account environmental and ecological considerations, the cost of construction, and the geological need for a location in a particular site. Lessor's consent for such location shall not be unreasonably withheld. Lessee will make every reasonable effort to give Lessor as much advance notice of its planned exploration and development program in order to permit Lessor and Lessee, or their representatives, to make on the ground plans for such locations. Lessor will use every reasonable effort to be available or have a representative available in order to meet with Lessee or Lessee's representatives within a reasonable time after notice. If emergency situations arise, each party will use every reasonable effort to accommodate the other party in order to achieve the purposes for which this lease is made.

7. Before using any road (existing or new) on the premises, Lessee shall first cause the same to be constructed

with compacted caliche of sufficient thickness to make the same an all-weather road, and such roads shall be watered with sufficient frequency to prevent the raising of excessive dust and the same shall be maintained in good passable condition, including adding additional caliche when necessary. No material used in road construction shall be brought in from off the premises. Any road constructed on the premises shall remain a private road only for the purpose of exploring, developing, producing and transporting oil and gas and products therefrom from the premises solely for the benefit of Lessee and those furnishing third party services to Lessee and for the use of Lessor and Lessor's permittees. No such roads shall be used as a primary means of ingress and egress to lands owned by third parties and shall not be so used for any such purpose without Lessor's consent. At each point where a road crosses a fence, Lessee will install, at Lessor's election, either a cattle guard, gate or combination cattle guard and gate. If a gate is elected, Lessee may install a cattle guard in addition to the gate. Prior to cutting a fence, Lessee will install on each side of the proposed cut a braced-end type post conforming with the recommended practices of the Soil Conservation Service and the existing fence will be firmly fixed as taut and as without sag as prior to being cut. Upon request by Lessor, or any one of them, the gates will be kept locked at all times except when traffic is passing therethrough. Upon any cessation of use of any such road by Lessee, at Lessor's request all caliche placed on such road will be removed and returned to the pit from which it came, however, Lessee, in lieu of removing such caliche may pay Lessor on the basis, of Five Thousand Two Hundred Fifty Dollars ($5,280.00) per mile of caliche road to be removed.

8. While operations are being conducted hereunder, all areas of operation and areas adjacent thereto, including but not limited to roads, will be kept free from junk, paper, cans, old [illegible], trash and all other forms of debris and within a reasonable time after drilling operations on each site are completed, the area will be finally cleansed and policed and, except to the extent needed to produce a well, caliche pads, earthen pits and structures shall be removed

to the end that all objects and structures foreign to the natural condition of the land will be eliminated. Upon any final abandonment of an area the same will promptly be policed and restored as herein provided. If the caliche used in operations cannot be placed in pits or similar excavations at the location, and then covered with topsoil, then the excess will be returned to the source pits. For failure to perform these covenants, the Lessee and each immediate and remote Assignee, shall be jointly and severally liable in Irion County, Texas, to Lessor for the reasonable cost of complying with these provisions. Lessee shall have the right to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing, at any time up to one hundred twenty (120) days after the termination of this lease. The following schedule of damages to be paid by Lessee to the owner of the surface as well as other damage and liquidated payments provided for in this lease shall be applicable during the primary term. After the expiration of the primary term the damages and liquidated payments shall be paid in accordance with the damages generally paid in that vicinity at that time, but in no event shall be less than the amount herein specified. The amounts herein set out are for the usual and customary damages reasonably expected to result from prudent and reasonable oil and gas operations and do not cover any unusual damages such as, by way of illustration but not limitation, damages to livestock, improvements, persons and the like. The damages herein provided shall be paid prior to the commencement of operations:

a. Two Dollars ($2.00) per rod multiplied by the length of a road proposed to be used for the first time by Lessee;

b. Five Hundred Dollars ($500.00) per location not covering more than two (2) acres;

c. One Dollar ($1.00) per road for flow and gathering lines;

d. Five Hundred Dollars ($500.00) per tank battery site covering not more than two (2) acres.

Any damages not specified in the foregoing schedule shall be paid on the basis of the customary amounts paid in that vicinity. Any caliche used in construction of roads or pads

for well locations and tank batteries shall be taken from the pit site designated by Lessor and the caliche shall be purchased from the owner of the surface on the basis of Fifty Cents (50¢) per cubic yard. So long as the haul distance of caliche is not unreasonably long, caliche shall be taken from existing pits.

9. Any obligation herein imposed upon Lessee shall likewise apply to any of Lessee's agents, servants, employees, contractors, representatives, parties furnishing third party services, or anyone coming on the premises pursuant to this Lease and Lessee shall be obligated to enforce compliance by such other parties and shall be liable to Lessor for any failure of compliance by any such parties. Lessee shall prohibit anyone acting under Lessee from coming on the premises with firearms, either in person or in vehicles or equipment and shall enforce this prohibition to the extent that there shall be full compliance therewith. Likewise, Lessee shall prohibit hunting of any nature on Lessor's ranch under lease herein by any party coming on the premises under this lease. Expressly this lease shall never be construed so as to permit Lessee or those acting under Lessee or third parties to engage in picnicing, sight-seeing or other recreational activities on the premises and Lessee shall use all reasonable efforts to prevent the same.

10. In the event production of oil or gas on the leased premises after once obtained shall cease from any cause at the expiration of the primary term hereof or at any time or times thereafter, this lease shall not terminate if the Lessee commences additional drilling or reworking operations within sixty (60) days thereafter, and the lease shall remain in full force and effect so long as such operations continue in good faith and in workmanlike manner without interruptions totaling more than sixty (60) days during any one such operation; and of such drilling or reworking operations resold in the production of oil or gas, the lease shall remain in full force and effect so long as oil or gas is produced therefrom in paying quantities.

11. Should Lessee be prevented from complying with any express or implied convenant of this lease, from conducting drilling operations thereon, or from producing oil or gas

therefrom, after effort made in good faith, by reason of war, rebellion, riots, strikes, acts of God, or by failure, accident or breakdown, mechanical or otherwise, of producing, treating, gathering or delivery facilities, plants or pipelines, including the necessity of making repair or alterations thereof, or any valid order, rule or regulation of government authority, then while so prevented, Lessee's obligation to comply with such covenant shall be suspended and Lessee shall not be liable for damages for failure to comply therewith, provided, however, that unless this lease is then being maintained in force by some other provisions hereof, nothing contained in this Paragraph 11 shall be construed to suspend the payment of delay rentals in order to maintain this lease in effect during the primary term in the absence of such drilling or reworking operations or production of oil or gas.

12. If the estate of either party hereto is assigned—and the privilege of assigning in whole or in part is expressly allowed—the covenants hereof shall extend to their heirs, executors, administrators, successors, or assigns, but no change in the ownership of the land or assignment of rentals or royalties shall be binding on the Lessee until after the Lessee has been furnished with a written transfer or assignment, or a certified copy thereof; and it is hereby agreed that in the event this lease shall be assigned as to a part or as to parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease insofar as it covers the part or parts of said lands upon which the said Lessee or any assignee thereof shall make due payment of said rental.

13. Lessee may, at any time, and from time to time, execute and deliver to the Lessor or place of record, a release or releases covering any portion or portions of the above described premises, and thereby surrender this lease as to such portion or portions, and be relieved of all subsequent obligations as to acreage surrendered. In the event any part of this lease is surrendered, as above provided, the delay rental then payable hereunder shall thereupon be re-

duced in the proportion that the acreage surrendered bears to the acreage which was covered by this lease immediately prior to such surrender, provided such release shall not thereby relieve the Lessee of any liabilities which may have accrued in connection with the lease prior to the surrender of such acreage. If a partial release or releases should result in the route of ingress and egress to the retained lands being across Lessor's other lands, including those which had been previously covered by this lease, and such route is unreasonably inconvenient or burdensome to Lessor, then Lessee and Lessor shall, in a manner similar to that set out in Paragraph 6 above, arrange for Lessee to relocate such roads.

14. Lessee, at its sole cost and expense, shall be responsible for all future abstract expense for separately supplementing Lessor's abstracts for the inclusion therein of any and all instruments directly resulting from or rising out of the recording of this lease. This obligation shall be separately applicable to each separately numbered tract covered hereby, and this obligation shall not finally terminate until such time as all releases have been filed which will terminate this lease as to all lands covered hereby; however, this obligation shall terminate as to each separately numbered tract when all releases necessary to release such tract from this lease have been filed and included in supplemental abstract for that tract. This obligation shall not only be that of the original Lessee but also of each Assignee of any interest herein of any tract covered hereby and same shall be joint and several and may be asserted by Lessor, Lessor's personal representatives, heirs or assigns against the original Lessee or any Assignee or at the option or Lessor against all Assignees.

15. If said Lessor owns a lesser interest in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided for shall be paid the said Lessor only in proportion which Lessor's interest bears to the whole and undivided fee, provided further however that this lease is made subject to all valid and outstanding oil, gas and mineral conveyances as well as royalty conveyances and agreements affecting the

land covered hereby now appearing of legal record in the office of the County Clerk of the County wherein the above lands are situated.

16. If for any reason during or after the primary term, a well or wells located on the above described land and capable of producing gas, gas condensate, or gas and gas condensate in paying quantities is or are shut in for a period of sixty (60) consecutive days, during which time oil and gas is not otherwise being produced hereunder, Lessee may on or before the expiration of said sixty-day period pay or tender to Sugg or deposit to the credit of Sugg in the depository bank as specified in Paragraph 2 above a sum of money equal to One Dollar ($1.00) if during the primary term or Five Dollars ($5.00) if after the primary term multiplied by the net number of mineral acres owned by Sugg in the tract hereinafter described and to Farmer or deposit to the credit of Farmer in the depository bank as specified in Paragraph 2 above a sum of money equal to One Dollar ($1.00) if during the primary term or Five Dollars ($5.00) if after the primary term multiplied by the net number of mineral acres owned by Farmar in the tract hereinafter described, with the banks specified in Paragraph 2 above and their respective successors acting as respective agents for Lessor and such banks shall continue as the depository for all such payments regardless of any devolution, change or division of the ownership of said lands; and if such tender, payments or deposits are made, it shall be considered under the provisions of this lease that gas is being produced from six hundred forty (640) acres of the leased premises on which such gas well is situated if such is completed in the Canyon formation or deeper and three hundred twenty (320) acres if such gas is being produced from a formation above the top of the Canyon formation, for one (1) year from the date such well was shut-in, and upon a like payment on or before such day each succeeding year it will be considered under all of the provisions of this Lease that gas is being produced from such six hundred forty (640) acres of land [or three hundred twenty (320) acres as the case may be] in paying quantities for the year immediately following. This privilege of paying a gas shut-in royalty as constructive produc-

tion of gas, under no circumstances, shall extend beyond December 1, 1985, unless a gas well is completed after December 1, 1985, in which case such payment, tender or deposit may be made for one (1) additional year ending twelve (12) months after such well is shut in.

17. The following terms have the following meanings herein:

(a) A producing or production unit is a tract of land in the shape of a square or a rectangle and wherever possible shall be a regular section of land or a regular subdivision of a section of land, e.g. a ½, ¼ or a fraction or part thereof and on which is located a well producing (actually or constructively) oil or gas and contains the following amount of acreage, with a ten percent (10%) tolerance:

(1) Eighty (80) acres if the well is producing oil from a formation above the top of the Canyon formation

(2) One hundred sixty (160) acres if the well is producing oil from the Canyon formation or deeper.

(3) Three hundred twenty (320) acres if the well is producing gas from a formation above the top of the Canyon formation.

(4) Six hundred forty (640) acres if the well is producing gas from the Canyon formation or deeper.

(b) A Drilling Block shall contain not more than three thousand two hundred (3,200) acres (with 10% tolerance) of contiguous land and insofar as reasonably practical shall consist of not more than five (5) sections of land. If a tract of land covered hereby is not contiguous to any other tract covered hereby, then such segregated tract may be included in a Drilling Block with the nearest noncontiguous tract covered by this lease. A section of land means a tract of land which is identified by a section or survey number, usually a block number, and a railway or original grantee designation and usually is in the form of a square and contains six hundred forty (640) acres, more or less, of land.

(c) Spud or commence a well means the actual commencement of the cutting of a hole and thereafter continued with reasonable and continuous diligence to a

depth sufficient to test a formation known to be potentially productive of oil or gas.

(d) Completion of a well is the day that the last of the drilling, production or completion rig or unit moves off the hole after the well is first drilled.

18. At the expiration of the primary term of this Lease, this Lease shall terminate as to all lands covered hereby and not included in a producing unit or in a Drilling Block or Blocks unless Lessee shall pay, tender or deposit to Sugg, as an advance royalty, an amount of money equivalent to Ten Dollars ($10.00) per acre multiplied by the net number of mineral acres owned by Sugg, and an amount of money equivalent to Ten Dollars ($10.00) per acre multiplied by the net number of mineral acres owned by Farmar and as to which Lessee elects to extend this lease. Such sum of money may be deposited to the appropriate depository bank as specified in Paragraph 2 hereof. Contemporaneously with such payment, Lessee shall designate, by appropriate legal description, the lands for which such payment is being made and contemporaneously with such payment, tender or deposit shall furnish Lessor written notice of such designation, mailed to P.O. Box 573, San Angelo, Texas 76901 or at such address as Lessor may in writing designate. If such payment is so made, then this Lease shall be extended as to the designated lands for one (1) year from said date. In like manner and upon like payments, tenders or deposits, this Lease may be further extended for like periods of one (1) year successively until December 1, 1985. During the time this Lease is being extended by the payment of such advance royalties, as to any lands which were designated as those to which this Lease is to be extended by the payments of an advance royalty [Ten Dollars ($10.00) per acre per year for all Lessors], this Lease may be extended beyond the next succeeding anniversary date only by the same being dedicated to a producing unit or by the payment of advance royalty as herein provided. On each anniversary date of this Lease after the primary term, this Lease shall terminate as to all lands which are not included in a production unit on which is located a producing (actually or constructively) well, included in a Drilling

Block which is being perpetuated by continuous drilling or included in the designated lands for which the Ten Dollar ($10.00) advance royalty per acre is being paid.

19. Before the expiration of the primary term, Lessee may select any number of Drilling Blocks as Lessee may elect, and, upon so doing, shall furnish Lessor a description of the land, included in each Drilling Block so selected. As to each Drilling Block, this Lease shall not terminate at the expiration of the primary term if within ninety (90) days after the expiration of the primary term Lessee commences a well on some portion of the land covered in that Drilling Block and within ninety (90) days after its completion commences another well and thereafter with no lapse of time of more than ninety (90) days between the completion of a well and the commencement of another well continues the drilling of additional wells until all lands in the Drilling Block contain a well which is actually or constructively producing oil or gas and to which well there has been dedicated a producing unit. If at any time Lessee fails to commence a well on some portion of a Drilling Block within ninety (90) days after the completion of the next preceding well in that block, then this Lease shall terminate as to all the lands in the Drilling Block, except for the lands included in a producing unit. The right to extend this Lease by the continuous drilling program herein set out, unless sooner terminated, shall terminate on December 1, 1985. Upon any termination of this Lease during the extended term just described, production from any well production from a formation above the top of the Canyon formation shall extend the Lease vertically from the surface to the base of the formation from which production is being obtained in that well unless there is actual or constructive production from a well in that Drilling Block which is producing from the Canyon formation or deeper, in which case this Lease shall be extended as to all of the producing units in that Block and as to all depths in each unit.

20. Except for any lands which are included in a producing unit on which is located a gas well which was completed in the last year of the extended term of this Lease (December 1, 1984 to December 1, 1985) and for which a gas shut-

in royalty payment has been properly made, this Lease shall terminate on December 1, 1985, as to all lands not dedicated to production under the applicable spacing regulations of the Railroad Commision of Texas, or its successor, and further, if a well is completed in and producing from a formation above the top of the Canyon Formation, then this Lease shall also terminate as to all zones, formations and horizons which are deeper than one hundred feet (100) below the depth of the deepest formation from which production is then being obtained in that well. If thereafter the Railroad Commission of Texas, or its successor, should change the spacing rules, and thereby reduce the size of proration units, then Lessee shall have ninety (90) days from the effective date of such rule change to commence a well and pursue a continuous drilling program with no interval of more than ninety (90) days from the date of completion of one (1) well until the commencement of a succeeding well, with the definition heretofore given being applicable to this situation, and if Lessee fails to commence a well within ninety (90) days from the date of completion of the next preceding well, then at that time this Lease shall terminate as to all acreage not dedicated to a production unit under the applicable spacing regulations of the Railroad Commission of Texas. After the expiration of the extended term, production from a well shall perpetuate this Lease only as to the acreage dedicated to that well under the applicable spacing regulations of the Railroad Commission of Texas, subject to the provision of the sixty (60) day re-working clause.

21. The fact that the Lease is signed by the Lessors and cover land the ownership of which differs between the Lessors shall not be considered to have the effect of unitization or communitization of the ownership of the lands covered but to the contrary, the royalty and other benefits reserved by the Lessor, inure only to the owner of such lands and in proportion to each parties' ownership therein.

22. If Lessee engages in drilling operations with the use of air or gas, then during all periods of operation, Lessee shall have a de-duster or dust eliminator in operating order and in operation.

23. Lessor hereby warrants and agrees to defend the title to the lands herein described and agrees that the Lessee shall have the right at any time to redeem for Lessor, by payment, any mortgages, taxes, or other liens on the above described lands, in the event of default of payment by Lessor, and be subrogated to the rights of the holder thereof.

24. Any notice herein required may be given in the following manner:

To Sugg at P.O. Box 573, San Angelo, Tom Green County, Texas 76901—telephone (915) 655-4486

To Farmar at 1410 Warwick Lane, Newport Beach, California 92660—telephone (714) 646-1426

To Allied Chemical Corporation or Florida Gas Exploration Company at the respective addresses shown above.

IN WITNESS WHEREOF this Oil and Gas Lease is executed effective December 1, 1975.

/s/ ANDREW SUGG
ANDREW A. SUGG

SUGG

/s/ PHILIP D. FARMAR
PHILIP D. FARMAR

/s/ NANCY FARMAR WARFIELD
NANCY FARMAR WARFIELD

/s/ ANDREA FARMAR BJELDANES
ANDREA FARMAR BJELDANES

/s/ PETER D. FARMAR
PETER D. FARMAR

/s/ PHILIP D. FARMAR
PHILIP D. FARMAR, as Testimentary Trustee under the Will of Samie June S. Farmar, Deceased, for the benefit of Steven S. Farmar

FARMAR

THE STATE OF TEXAS)(
COUNTY OF TOM GREEN)(

BEFORE ME, the undersigned authority, on this day personally appeared ANDREW A. SUGG, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 14 day of December, 1975

/s/ W. TRUETT SMITH

W. TRUETT SMITH
Notary Public in and for Tom Green County, Texas

THE STATE OF CALIFORNIA)(
COUNTY OF ORANGE)(

BEFORE ME, the undersigned authority, on this day personally appeared PHILIP D. FARMAR, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed and in the capacity therein stated.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 15 day of December, 1975

/s/ JANANNE HOLDEN

JANANNE HOLDEN
Notary Public in and for Orange County, California

THE STATE OF CALIFORNIA)(
COUNTY OF MARIN)(

BEFORE ME, the undersigned authority, on this day personally appeared NANCY FARMAR WARFIELD, known to me to be the person whose name is subscribed to the foregoing insrument, and acknowledged to me that she executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 16 day of December, 1975

/s/ K. L. BOOSEY

K. L. BOOSEY
Notary Public in and for Marin County, California

THE STATE OF CALIFORNIA)(
COUNTY OF LOS ANGELES)(

BEFORE ME, the undersigned authority, on this day personally appeared ANDREA FARMAR BJELDANES, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that she executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY AND AND SEAL OF OFFICE this 18th day of December, 1975

/s/ RUTH H. ALFARMER

RUTH H. ALFARMER
Notary Public in and for Los Angeles County, California

THE STATE OF CALIFORNIA)(
COUNTY OF SAN DIEGO)(

BEFORE ME, the undersigned authority, on this day personally appeared PETER D. FARMAR, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 15 day of December, 1975

/s/ JANANNE HOLDEN

JANANNE HOLDEN
Notary Public in and for San Diego County, California

EXHIBIT "A"

December 1, 1975

OIL AND GAS LEASE
ANDREW A. SUGG, PHILIP D. FARMAR, ET AL, LESSOR
ALLIED CHEMICAL CORPORATION AND FLORIDA GAS EXPLORATION COMPANY, LESSEE

All of the following described lands and interests therein in Irion County, Texas:

Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
		Following Lands in Block 6, H.&T.C. RR Co.:				
1	1	312	493	246.5	246.5	
2	2	951	640	320	320	
3	3	313	640	320	320	
4	4	1255; 897; 1228	640	320	320	
5	5	314	640	320	320	
6	6	916	640	320	320	
7	7	315	640	320	320	
8	9	316	640	320	320	
9	11	317	640	320	320	
10	12	915	640	320	320	
11	13	318	640	320	320	
12	14	1148	640	320	320	
13	15	319	640	320	320	
14	19	321	640	320	320	
15	20	950	643	321.5	321.5	
16	21	322	640	320	320	
17	22	917	642	321	321	
18	23	323	640	320	320	
19	24	1265	640	320	320	
20	25	324	640	320	320	
21	26	914	646	323	323	
22	27	325	640	320	320	
23	29	326	640	320	320	
24	38	976	642.8	321.4	321.4	
25	39	331	640	320	320	
26	40	1266	640	320	320	
27	41	332	640	320	320	
		Following Lands in Block 28, H.&T.C. RR Co.:				
28	3057	195	642.2	321.1	321.1	
29	E/23058	898	362.75	181.37	181.38	
30	3059	205	646.1	323.1	323.0	
31	3060	899	791.3	395.6	395.7	
32	¾ths interest in 3061	204	501.8	334.5	83.6	83.7
33	3067	192	662	331	331	
34	3069	203	690.6	345.3	345.3	
35	3070	924	642.3	321.2	321.1	
36	3071	197	644	322	322	

Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
37	¾ths interest in 3072	927	480	320	80	80
38	¾ths interest in 3073	202	480	320	80	80
39	3089	1177	190	95	95	
		Following Lands in Block 1, H.&T.C. RR Co.:				
40	4	1039	640	320	320	
41	5	233	640	320	320	
42	E/2 6	942	320	160	80	80
43	11	236	640	320	160	160
44	12	752	640	320	160	160
45	S/2 17	239	320	160	80	80
46	29	245	640	320	160	160
47	30	743	640	320	160	160
48	31	246	640	320	160	160
49	32	958	640	320	160	160
50	S. Pt.33	247	173	86.5	43.3	43.2
51	N/2 37	249	320	160	80	80
52	S/2 44	1061	320	160	80	80
53	S/2 45	253	320	160	80	80
54	46	770	640	320	160	160
55	47	254	640	320	160	160
56	48	1053	640	320	160	160
57	49	255	640	320	160	160
58	50	960	640	320	160	160
59	51	256	640	320	160	160
60	52	959	640	320	160	160
61	53	257	640	320	160	160
62	54	905	640	320	160	160
63	55	258	640	320	160	160
64	56	1063	640	320	160	160
65	57	259	640	320	160	160
66	67	264	640	320	160	160
67	69	265	640	320	160	160
68	70	1115	640	320	160	160
69	71	266	640	320	160	160
70	73	267	640	320	160	160
71	88	1112	640	320	160	160
72	89	275	640	320	160	160
		Following Lands which are not in Blocks:				
73	1898, D Verbene	643	640	320	320	
74	1894, E. Heinrich	162	640	320	320	
75	1895, E.W. Weygand	654	420	210	210	
76	1896 A. Wiman	657	320	160	160	
77	1897, A. Wiman	658	320	160	160	
78	3044, J. McNeese	466	640	320	320	
79	E. Pt., Sur. 2 D.C. Caldwell	1085	601.8	300.9	300.9	

JOINT EXHIBIT B

DEFERRED BONUS AGREEMENT

WHEREAS on December 1, 1975, ANDREW A. SUGG, and others, as Lessor, executed and delivered to ALLIED CHEMICAL CORORATION, 1330 Wilco Building, Midland, Texas 79701 and FLORIDA GAS EXPLORATION COMPANY, 2240 The 1100 Milam Building, Houston, Texas 77002, as Lessee, an Oil and Gas Lease covering lands in Irion County, Texas, which lands are described in Exhibit "A" attached hereto and made a part hereof.

WHEREAS the total consideration to ANDREW A. SUGG for the execution and delivery of such lease is One Million Fifty-seven Thousand Five Hundred Forty-three and 60/100 Dollars ($1,057,543.60), which, as part of the agreement between the parties, is to be paid as hereinafter provided.

NOW THEREFORE, for and in consideration of the premises, ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPANY, jointly and severally, do hereby agree to pay to ANDREW A. SUGG the total sum of One Million Fifty-seven Thousand Five Hundred Forty-three and 60/100 Dollars ($1,057,543.60) as follows:

On or before December 25, 1975	$ 1,000.00
Between January 10 and January 20, 1976	528,271.80
Between January 10 and January 20, 1978	528,271.80
	$1,057,543.60

Such deferred sum shall bear no interest and shall be paid by bank cashier's check payable to ANDREW A. SUGG and delivered to him in person or mailed to him at P.O. Box 573, San Angelo, Texas 76901 or deposited to the account of Andrew A. Sugg in The First National Bank, San Angelo, Texas.

The right to receive the moneys herein provided to be paid to ANDREW A. SUGG is not assignable or transferable by ANDREW A. SUGG, but to the contrary, the same is personal and may be paid only to ANDREW A. SUGG or upon the death of ANDREW A. SUGG to the Estate of ANDREW A. SUGG. The contract rights herein given to

said ANDREW A. SUGG are not negotiable and the date of the payment of the obligations herein provided may not be accelerated.

In the event of an assignment of the Oil and Gas Lease, any unpaid balance due to ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPANY to ANDREW A. SUGG shall never constitute a lien or an encumbrance of any nature, either express or implied, upon the rights, titles and properties passing to the Lessee under said lease, but the contrary, the obligations herein imposed upon ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPANY are the joint and several obligations of said two parties, but such obligations are not secured.

EXECUTED in triplicate originals this 12th day of December, 1975.

/s/ ANDREW A. SUGG

ANDREW A. SUGG
Lessor

ALLIED CHEMICAL CORPORATION

By: A. A. BONNER, JR.*

A. S. BONNER, JR.

FLORIDA GAS EXPLORATION COMPANY

By: KENNETH E. MASTERS

KENNETH E. MASTERS
Vice President

**Executive Vice President*
Union Texas Petroleum

EXHIBIT "A"

December 1, 1975

OIL AND GAS LEASE
ANDREW A. SUGG, PHILIP D. FARMAR, ET AL, LESSOR
ALLIED CHEMICAL CORPORATION AND FLORIDA GAS EXPLORATION COMPANY, LESSEE

All of the following described lands and interests therein in Irion County, Texas:

Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
		Following Lands in Block 6, H.&T.C. RR Co.:				
1	1	312	493	246.5	246.5	
2	2	951	640	320	320	
3	3	313	640	320	320	
4	4	1255; 897; 1228	640	320	320	
5	5	314	640	320	320	
6	6	916	640	320	320	
7	7	315	640	320	320	
8	9	316	640	320	320	
9	11	317	640	320	320	
10	12	915	640	320	320	
11	13	318	640	320	320	
12	14	1148	640	320	320	
13	15	319	640	320	320	
14	19	321	640	320	320	
15	20	950	643	321.5	321.5	
16	21	322	640	320	320	
17	22	917	642	321	321	
18	23	323	640	320	320	
19	24	1265	640	320	320	
20	25	324	640	320	320	
21	26	914	646	323	323	
22	27	325	640	320	320	
23	29	326	640	320	320	
24	38	976	642.8	321.4	321.4	
25	39	331	640	320	320	
26	40	1286	640	320	320	
27	41	332	640	320	320	
		Following Lands in Block 28, H.&T.C. RR Co.:				
28	3057	195	642.2	321.1	321.1	
29	E/2 3058	800	362.75	181.37	181.38	
30	3059	205	646.1	323.1	323.0	
31	3060	889	791.3	395.6	395.7	
32	¼ths interest in 3061	204	501.8	334.5	83.6	83.7
33	3067	192	662	331	331	
34	3069	203	690.6	345.3	345.3	
35	3070	924	642.3	321.2	321.1	
36	3071	197	644	322	322	

Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
37	¾ths interest in 3072	927	480	320	80	80
38	¾ths interest in 3073	202	480	320	80	80
39	3089	1177	190	95	95	
		Following Lands in Block 1, H.&T.C. RR Co.:				
40	4	1039	640	320	320	
41	5	233	640	320	320	
42	E/2 6	942	320	160	80	80
43	11	236	640	320	160	160
44	12	752	640	320	160	160
45	S/2 17	239	320	160	80	80
46	29	245	640	320	160	160
47	30	743	640	320	160	160
48	31	246	640	320	160	160
49	32	958	640	320	160	160
50	S. Pt.33	247	173	86.5	43.3	43.2
51	N/2 37	249	320	160	80	80
52	S/2 44	1061	320	160	80	80
53	S/2 45	253	320	160	80	80
54	46	770	640	320	160	160
55	47	254	640	320	160	160
56	48	1053	640	320	160	160
57	49	255	640	320	160	160
58	50	960	640	320	160	160
59	51	256	640	320	160	160
60	52	959	640	320	160	160
61	53	257	640	320	160	160
62	54	905	640	320	160	160
63	55	258	640	320	160	160
64	56	1063	640	320	160	160
65	57	259	640	320	160	160
66	67	264	640	320	160	160
67	69	265	640	320	160	160
68	70	1115	640	320	160	160
69	71	266	640	320	160	160
70	73	267	640	320	160	160
71	88	1112	640	320	160	160
72	89	275	640	320	160	160
		Following Lands which are not in Blocks:				
73	1890, D Verbene	643	640	320	320	
74	1894, E. Heinrich	162	640	320	320	
75	1896, E. W. Weygand	654	420	210	210	
76	1898 A. Wiman	657	320	160	160	
77	1897, A. Wiman	658	320	160	160	
78	3044, J. McNeese	468	640	320	320	
79	E. Pt., Sur. 2 D.C. Caldwell	1085	601.8	300.9	300.9	

JOINT EXHIBIT C
DEFERRED BONUS AGREEMENT

WHEREAS on December 1, 1975, PHILIP D. FARMAR, NANCY FARMAR WARFIELD (formerly called Nancy Farmar), ANDREA FARMAR BJELDANES (formerly called Andrea Farmar), PETER D. FARMAR, and PHILIP D. FARMAR, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased, for the benefit of Steven S. Farmar, herein collectively called "Farmar", and others, as Lessor, executed and delivered to ALLIED CHEMICAL CORPORATION, 1300 Wilco Building, Midland, Texas 79701 and FLORIDA GAS EXPLORATION COMPANY, 2240 The 1100 Milam Building, Houston, Texas 77002, as Lessee, an Oil and Gas Lease covering lands in Irion County, Texas, which lands are described in Exhibit "A" attached hereto and made a part hereof.

WHEREAS the total consideration to Farmar for the execution and delivery of such lease is One Million Thirty-five Thousand Six Hundred Fifteen and 16/100 Dollars ($1,035,615.16), which, as part of the agreement between the parties, is to be paid as hereinafter provided.

NOW THEREFORE, for and in consideration of the premises, ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPANY, jointly and severally, do hereby agree to pay to PHILIP D. FARMAR, NANCY FARMAR WARFIELD (formerly called Nancy Farmar), ANDREA FARMAR BJELDANES (formerly called Andrea Farmar), PETER D. FARMAR, and PHILIP D. FARMAR, as Testamentary Trustee under the will of Sammie June S. Farmar, Deceased, for the benefit of Steven S. Farmar, the total sum of One Million Thirty-five Thousand Six Hundred Fifteen and 16/100 Dollars ($1,035,615.16) as follows:

On or before December 25, 1975	5,000.00
Between January 10 and January 20, 1976	257,653.90
Between January 10 and January 20, 1977	257,653.90
Between January 10 and January 20, 1978	257,653.90
Between January 10 and January 20, 1979	257,653.90
	$1,035,615.60

The above sum of money and each installment thereof shall be owned in the following proportions:

Philip D. Farmar, Individually—18,326.78/23,013.68;
Nancy Farmar Warfield—¼ x 4,686,90/23,013.68;
Andrea Farmar Bjeldanes—¼ x 4,686.90/23,013.68;
Peter D. Farmar—¼ x 4,686.90/23,013.68;
Philip D. Farmar, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased, for the benefit of Steven S. Farmar—¼ x 4,686.90/23,013.68:

however, for purposes of convenience between the parties just mentioned and for no other purpose, any moneys due hereunder shall be paid by bank cashier's check payable to PHILIP D. FARMAR, Agent, and delivered to PHILIP D. FARMAR at 1410 Warwick Lane, Newport Beach, California, or mailed to PHILIP D. FARMER, Agent, at P.O. Box 573, San Angelo, Tom Green County, Texas 76901 or deposited to the account of Philip D. Farmar, Agent, Account No. 204-424-2,in The Central National Bank of San Angelo, San Angelo, Texas.

The deferred sums of money to be paid herein shall not bear interest and the right to receive the moneys herein provided is not assignable by any of the parties entitled to receive the same, but to the contrary, such rights are personal to each of the parties entitled to receive the same and so long as all such parties are living the same shall be paid as herein provided; however, upon the death of any one of the parties entitled to receive the moneys, the deceased party's interest in the money shall be payable to the estate of the deceased and not otherwise. The contract rights herein given to the parties entitled to receive such sums are not negotiable and the date of payment of the obligations herein provided may not be accelerated.

In the event of an assignment of the Oil and Gas Lease, any unpaid balance due by ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPA-

NY to Farmar shall never constitute a lien or an encumbrance of any nature, either express or implied, upon the rights, titles and properties passing to the Lessee under said lease, but to the contrary, the obligations herein imposed upon ALLIED CHEMICAL CORPORATION and FLORIDA GAS EXPLORATION COMPANY are the joint and several obligations of said two parties, but such obligations are not secured.

EXECUTED in triplicate originals this 12 day of December, 1975.

/s/ _____
PHILIP D. FARMAR

/s/ _____
NANCY FARMAR WARFIELD

/s/ _____
ANDREA FARMAR BJELDANES

/s/ _____
PETER D. FARMAR

/s/ _____
PHILIP D. FARMAR, as Testamentary Trustee under the Will of Sammie June S. Farmar, Deceased for the benefit of Steven S. Farmar

LESSOR

ALLIED CHEMICAL CORPORATION
A.S. BONNER, JR.*
FLORIDA GAS EXPLORATION COMPANY

/s/ _____
KENNETH E. MASTERS
Vice President

LESSEE

*Executive Vice President
Union Texas Petroleum Division

EXHIBIT "A"

December 1, 1975

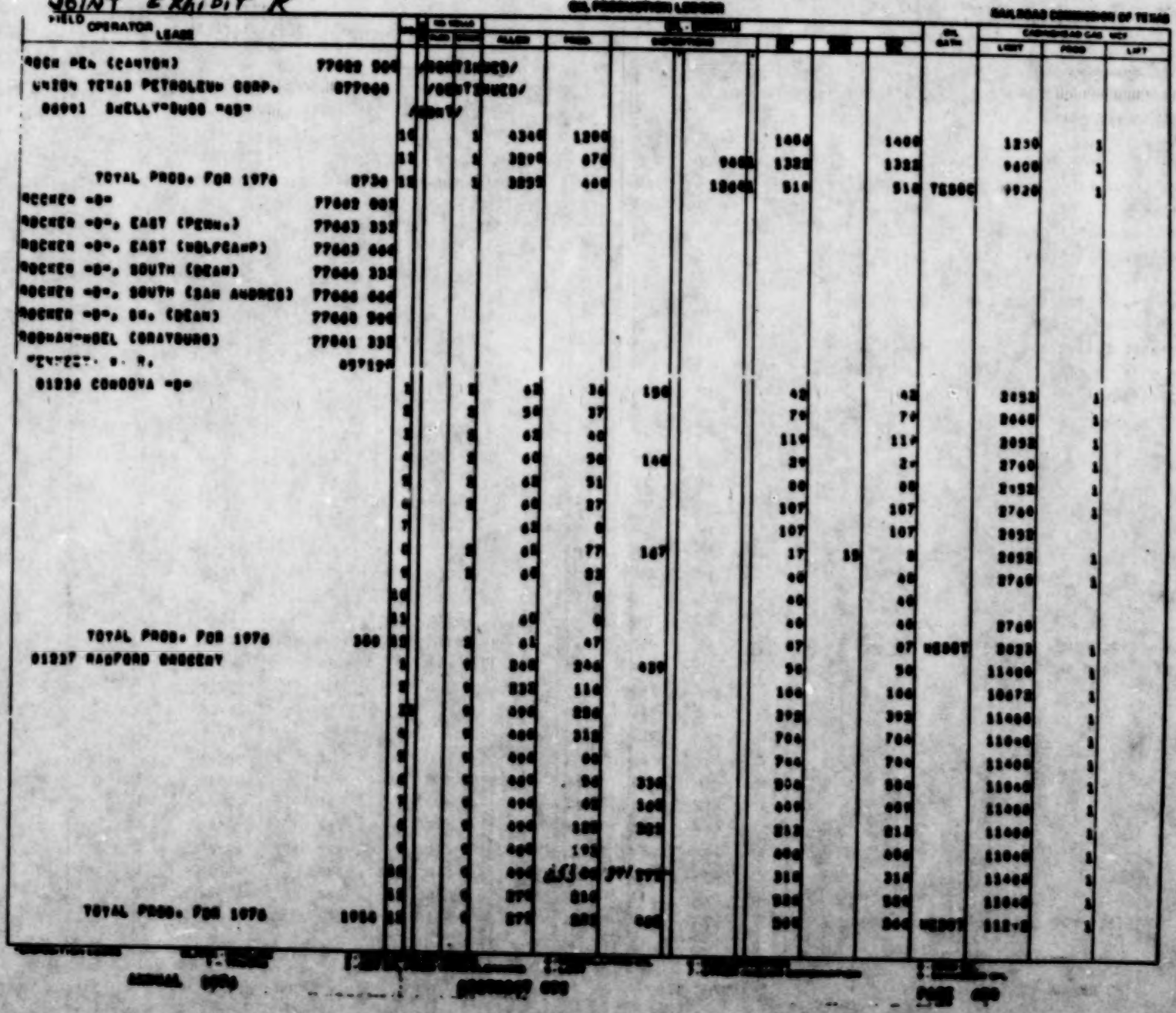
OIL AND GAS LEASE
ANDREW A. SUGG, PHILIP D. FARMAR, ET AL, LESSOR
ALLIED CHEMICAL CORPORATION AND FLORIDA GAS EXPLORATION COMPANY, LESSEE

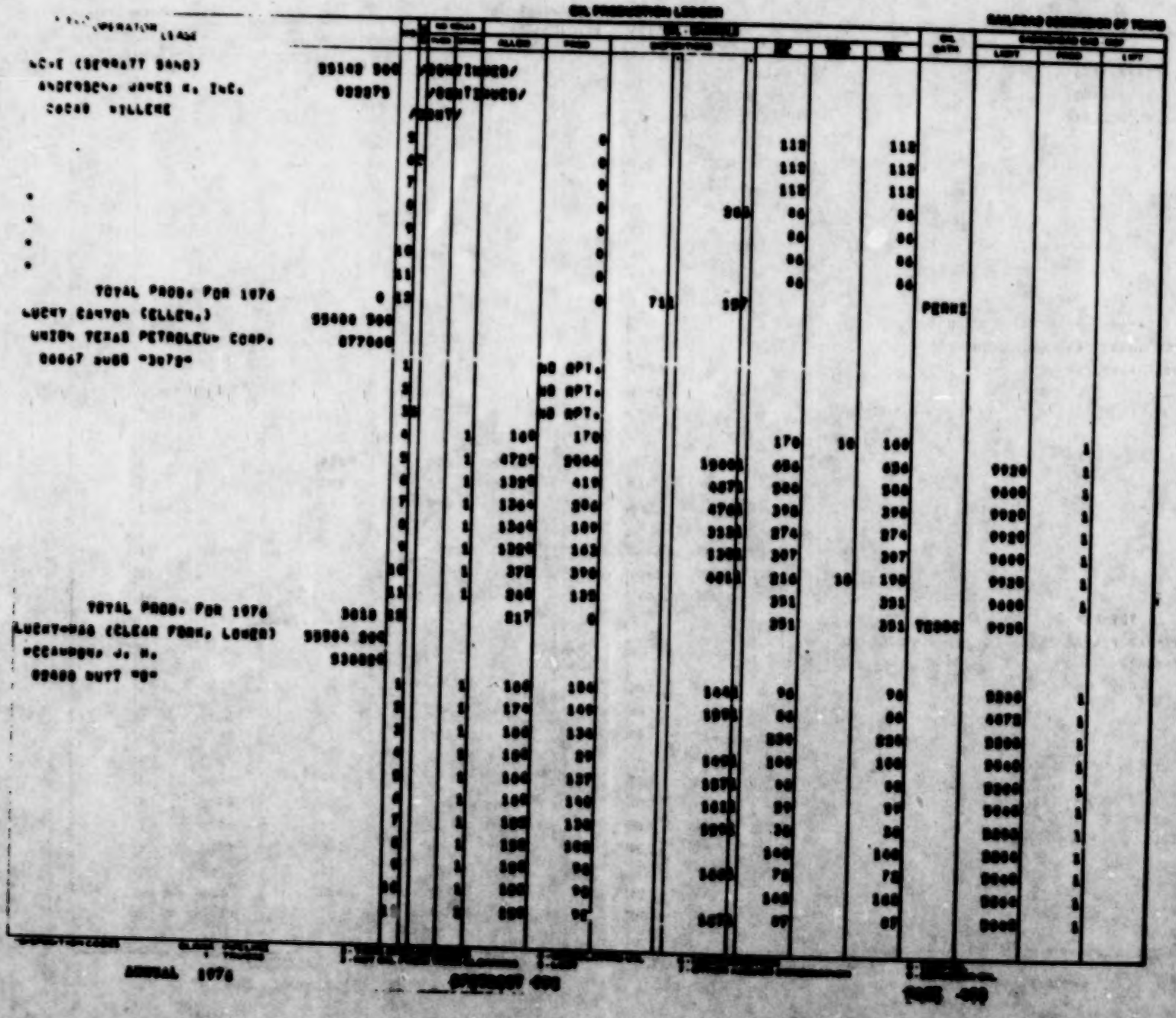
All of the following described lands and interests therein in Irion County, Texas:

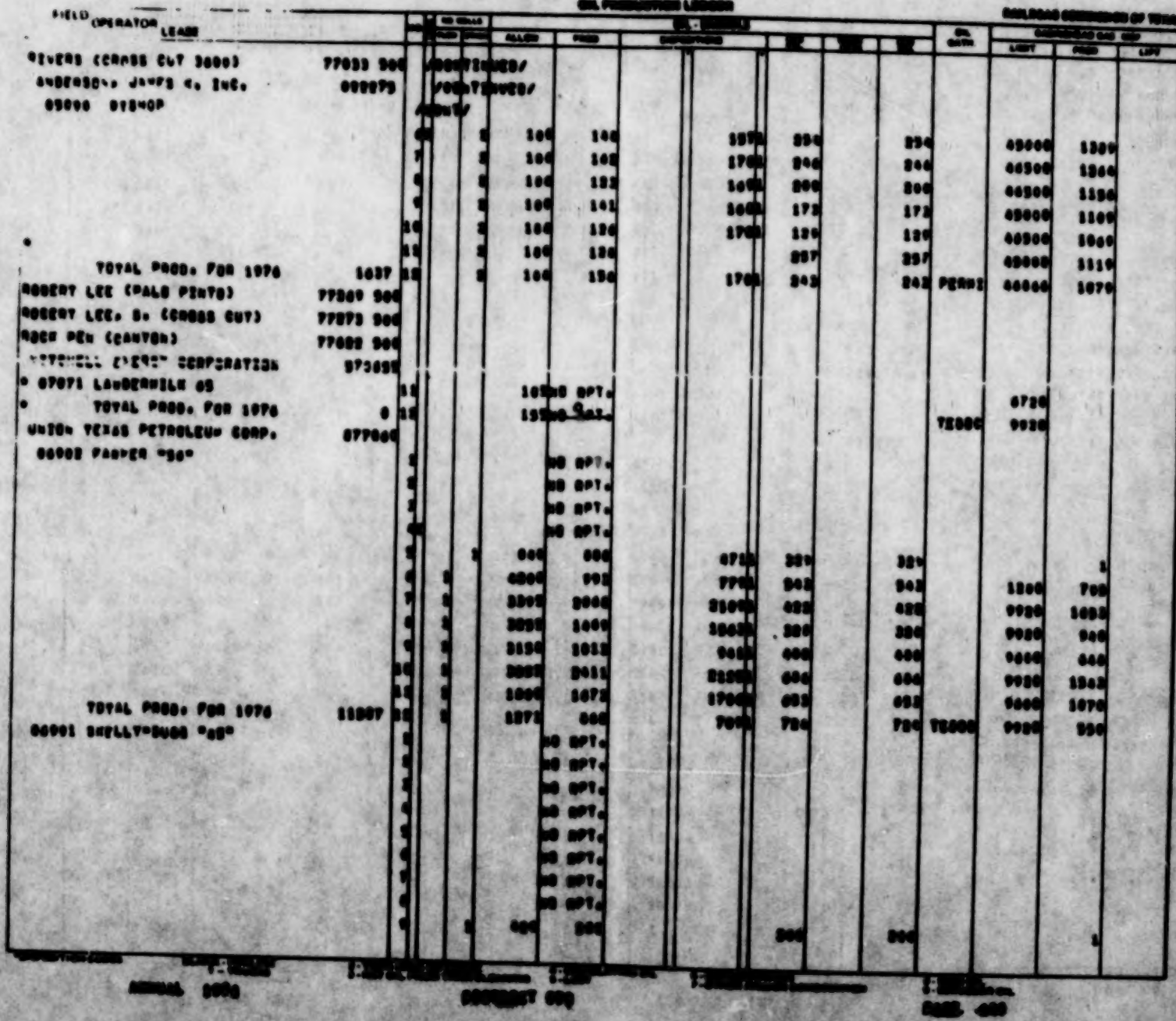
Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
		Following Lands in Block 6, H.&T.C. RR Co.:				
1	1	312	493	246.5	246.5	
2	2	951	640	320	320	
3	3	313	640	320	320	
4	4	1255; 897; 1228	640	320	320	
5	5	314	640	320	320	
6	6	916	640	320	320	
7	7	315	640	320	320	
8	9	316	640	320	320	
9	11	317	640	320	320	
10	12	915	640	320	320	
11	13	318	640	320	320	
12	14	1148	640	320	320	
13	15	319	640	320	320	
14	19	321	640	320	320	
15	20	950	643	321.5	321.5	
16	21	322	640	320	320	
17	22	917	642	321	321	
18	23	323	640	320	320	
19	24	1265	640	320	320	
20	25	324	640	320	320	
21	26	914	646	323	323	
22	27	325	640	320	320	
23	29	326	640	320	320	
24	38	976	642.8	321.4	321.4	
25	39	331	640	320	320	
26	40	1266	640	320	320	
27	41	332	640	320	320	
		Following Lands in Block 28, H.&T.C. RR Co.:				
28	3057	195	642.2	321.1	321.1	
29	E/23058	898	362.75	181.37	181.38	
30	3059	205	646.1	323.1	323.0	
31	3060	899	791.3	395.6	395.7	
32	¾ths interest in 3061	204	501.8	334.5	83.6	83.7
33	3067	192	662	331	331	
34	3069	203	690.6	345.3	345.3	
35	3070	924	642.3	321.2	321.1	
36	3071	197	644	322	322	

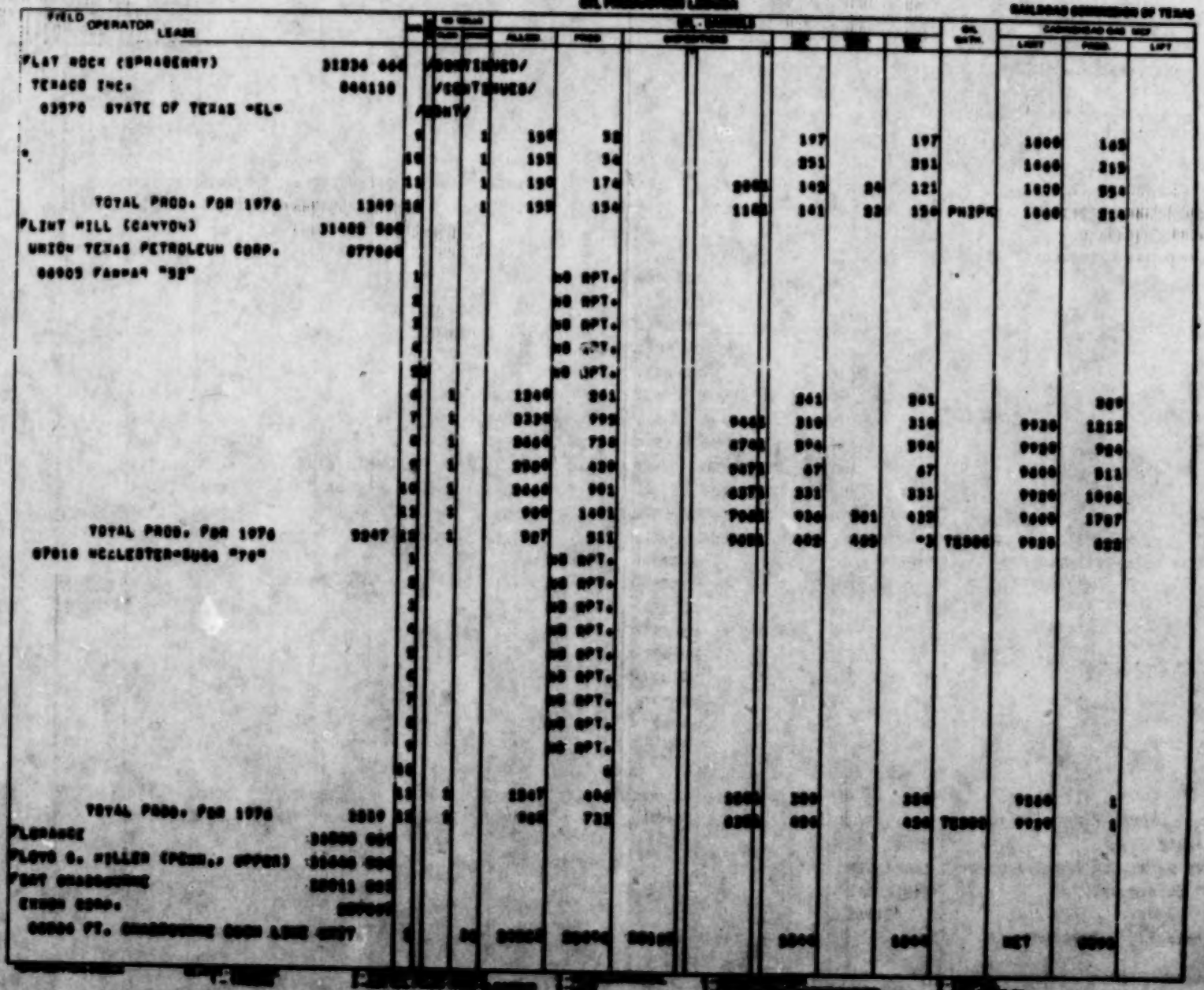
Tract No.	Survey No.	Abstract No.	Lessor's Gross Mineral Acres	Andrew A. Sugg Net Mineral Acres	Philip D. Farmar Net Mineral Acres	Combined Net Mineral Acres Of 4 Farmar Children With Each Owning ¼th Thereof
37	¾ths interest in 3072	927	480	320	80	80
38	¾ths interest in 3073	202	480	320	80	80
39	3089	1177	190	95	95	
		Following Lands in Block 1, H.&T.C. RR Co.:				
40	4	1039	640	320	320	
41	5	233	640	320	320	
42	E/2 6	942	320	160	80	80
43	11	236	640	320	160	160
44	12	752	640	320	160	160
45	S/2 17	239	320	160	80	80
46	29	245	640	320	160	160
47	30	743	640	320	160	160
48	31	246	640	320	160	160
49	32	958	640	320	160	160
50	S. Pt.33	247	173	86.5	43.3	43.2
51	N/2 37	249	320	160	80	80
52	S/2 44	1061	320	160	80	80
53	S/2 45	253	320	160	80	80
54	46	770	640	320	160	160
55	47	254	640	320	160	160
56	48	1053	640	320	160	160
57	49	255	640	320	160	160
58	50	960	640	320	160	160
59	51	256	640	320	160	160
60	52	959	640	320	160	160
61	53	257	640	320	160	160
62	54	905	640	320	160	160
63	55	258	640	320	160	160
64	56	1063	640	320	160	160
65	57	259	640	320	160	160
66	67	264	640	320	160	160
67	69	265	640	320	160	160
68	70	1115	640	320	160	160
69	71	266	640	320	160	160
70	73	267	640	320	160	160
71	88	1112	640	320	160	160
72	89	275	640	320	160	160
		Following Lands which are not in Blocks:				
73	1893, D Verbene	643	640	320	320	
74	1894, E. Heinrich	162	640	320	320	
75	1895, E.W. Weygand	654	420	210	210	
76	1896 A. Wiman	657	320	160	160	
77	1897, A. Wiman	658	320	160	160	
78	3044, J. McNeese	466	640	320	320	
79	E. Pt., Sur. 2 D.C. Caldwell	1085	601.8	300.9	300.9	

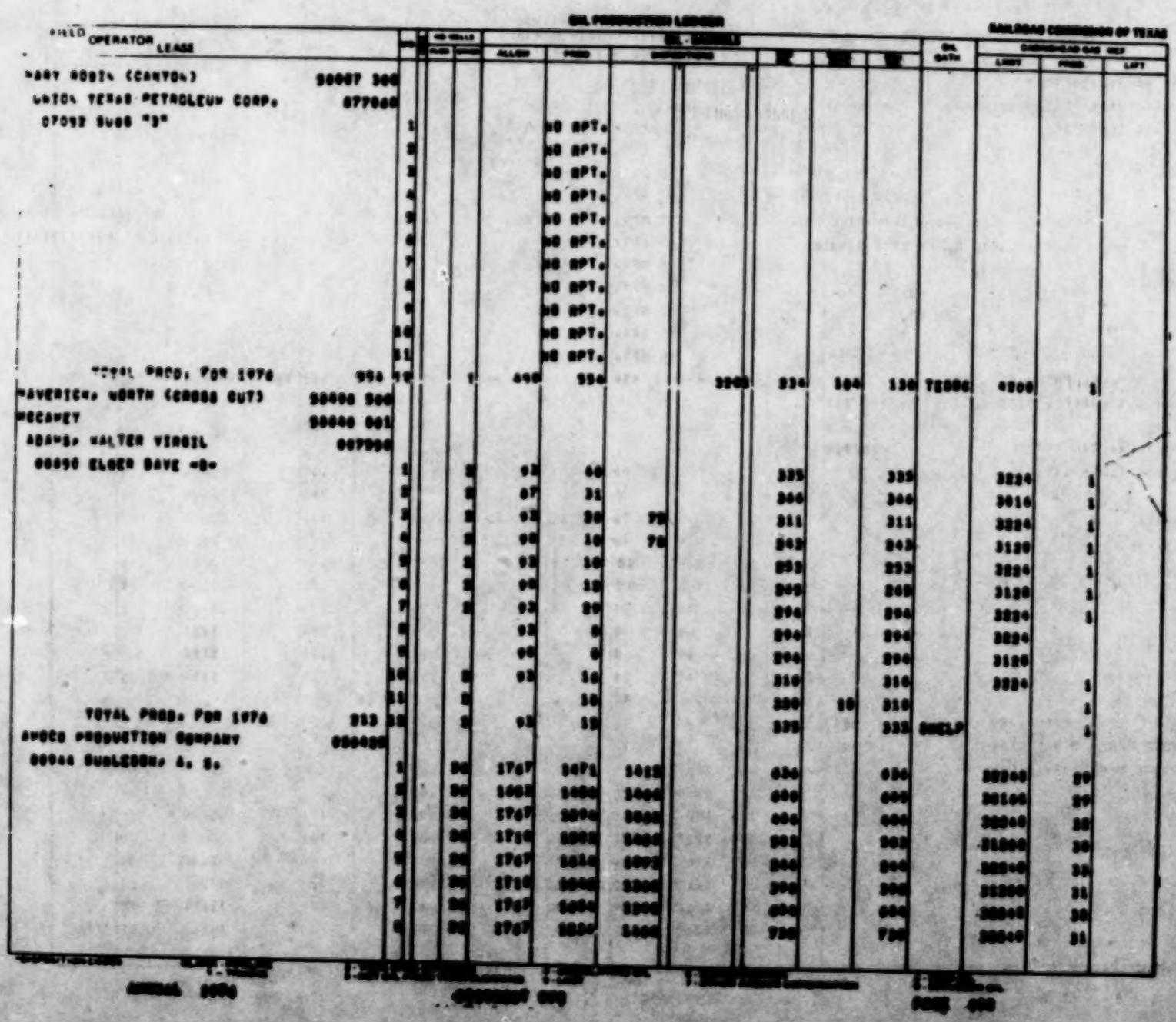
JOINT EXHIBIT K




OIL PRODUCTION LEDGER
RAILROAD COMMISSION OF TEXAS
TOTAL PROD. FOR 1976
LUCKY CANYON (ELLEN.)
UNION TEXAS PETROLEUM CORP.
TOTAL PROD. FOR 1976
LUCKY-ORR (CLEAR FORK, LOWER)
ANNUAL 1976







IN THE UNITED STATES
COURT OF CLAIMS

No. 15-80T

PHILLIP D. FARMER AND MARIAN J. FARMAR, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

No. 16-80T

A. A. SUGG AND MARY S. SUGG, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

AFFIDAVIT OF BOB BALES

THE STATE OF TEXAS
COUNTY OF MIDLAND

BEFORE ME, the undersigned authority, on this day appeared BOB BALES, who, after being duly sworn, did depose and state as follows.

1. I, BOB BALES, am an independent landman actively engaged in the acquisition and sale of oil and gas leases in the area of West Texas and Southeast New Mexico known as the Permian Basin. Most of the leases which I acquire are sold to large independent oil companies that do not possess sufficient personnel to establish a prospect to explore for and produce oil and gas. The purpose of this affidavit is to set forth the facts of which I have knowledge relevant to the issue in the above-captioned federal income tax litigation.

2. In my capacity as an independent landman, I acted as a middleman between (a) Phillip D. Farmar and Marian J. Farmar and A. A. Sugg and Mary S. Sugg and (b) Union

Texas Petroleum Corporation in negotiating the oil and gas leases in issue in the above-captioned federal income tax litigation.

3. When negotiating the terms of an oil and gas lease similar to the leases in issue in this litigation, the amount of bonus and the royalty percentage of production will vary. There is a definite interrelationship between bonus and royalty; the bonus may be balanced against the royalty when negotiating the lease. If a greater amount is received as a bonus, the percentage of production received as a royalty can be decreased.

4. In negotiating an oil and gas lease, as an inducement to obtain a lease from a mineral owner, a lessee will increase the royalty and decrease the bonus or decrease the royalty and increase the bonus. Balancing bonus against royalty is considered standard procedure when negotiating an oil and gas lease.

5. I have personal knowledge of the facts contained in this affidavit, am of sound mind, am over twenty-one years of age, am fully competent to make this affidavit and make this affidavit in support of the Cross-Motion of the Plaintiffs for Summary Judgment in this case.

/s/ BOB BALES
BOB BALES

SUBSCRIBED AND SWORN TO before me this 28th day of July, 1981.

/s/ VALERIE A. DOPSON
Notary Public in and for
Midland County, Texas

IN THE UNITED STATES
COURT OF CLAIMS

No. 15-80T

PHILLIP D. FARMAR AND MARIAN J. FARMAR, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

No. 16-80T

A. A. SUGG AND MARY S. SUGG, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

AFFIDAVIT OF JESSE M. CHIPMAN, III

THE STATE OF TEXAS
COUNTY OF TOM GREEN

BEFORE ME, the undersigned authority, on this day appeared JESSE M. CHIPMAN, III, who, after being duly sworn, did depose and state as follows.

1. I, JESSE M. CHIPMAN, III, am an independent landman. I operate as a middleman between companies which desire to acquire oil and gas leases and mineral owners. I have worked as a landman since October 1959, operating primarily in Texas, Arkansas, Louisiana and Mississippi but also in New Mexico, Oklahoma and Kansas. The purpose of this affidavit is to set forth the facts of which I have knowledge relevant to the issue in the above-captioned federal income tax litigation.

2. The three primary variable factors which are significant in negotiating the terms of an oil and gas lease are the amount of bonus, the percentage of oil and gas production

which constitutes the royalty and the length of the primary term of the lease.

3. The amount of the bonus and the royalty percentage are closely related in negotiating the terms of an oil and gas lease. As the amount of the bonus increases, the royalty percentage will decrease, and vice-versa.

4. The interrelationship between bonus and royalty is illustrated by the terms which a certain company recently offered mineral owners in negotiating oil and gas leases in Tom Green County, Texas. In this particular case, a mineral owner was given the option of receiving a bonus of $25 per acre and a one-sixth royalty or a bonus of $35 per acre and one-eighth royalty. In other words, an increase in bonus would result in a decrease in the royalty percentage while a decrease in the bonus would result in an increase in the royalty precentage.

5. I viewed the interrelationship between bonus and royalty when negotiating oil and gas leases covering portions of a single tract of land in Motley County, Texas. Because the two lessors had different monetary needs, a portion of the tract was leased in exchange for a bonus of $15 per acre and a one-sixth royalty while another portion of the tract was leased in exchange for no bonus and a one-fourth royalty. The other terms of the two leases were very similar. As the amount of the bonus increased, the negotiations assured that the royalty percentage would decrease.

6. I have personal knowledge of the facts contained in this affidavit, am of sound mind, am over twenty-one years of age, am fully competent to make this affidavit and make this affidavit in support of the Cross-Motion of the Plaintiffs for Summary Judgment in this case.

/s/ JESSE M. CHIPMAN III
JESSE M. CHIPMAN III

SUBSCRIBED AND SWORN TO before me this 27th day of July, 1981.

PAULETTE PIERCE
Notary Public in and for
Tom Green County, Texas

IN THE UNITED STATES
COURT OF CLAIMS

No. 15-80T

PHILLIP D. FARMAR AND MARIAN J. FARMAR, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

No. 16-80T

A. A. SUGG AND MARY S. SUGG, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

AFFIDAVIT OF DON DOW

THE STATE OF TEXAS
COUNTY OF MIDLAND

BEFORE ME, the undersigned authority, on this day appeared DON DOW, who, after being duly sworn, did depose and state as follows.

1. I, DON DOW, am a district landman for Union Texas Petroleum ("Union Texas") and have held this position since 1969. From 1958 until entering employment with Union Texas, I held the position of landman with Mid-West Oil Corporation. In my position with Union Texas, I am responsible for acquiring oil and gas leases on behalf of Union Texas. The purpose of this affidavit is to set forth the facts of which I have knowledge relevant to the issue in the above-captioned federal income tax litigation.

2. In my capacity as district landman for Union Texas, I am responsible for obtaining oil and gas leases in the Permian Basin, an area encompassing portions of West Texas and the Southeast portion of New Mexico. Union Texas has

acquired oil and gas leases in the Permian Basin covering approximately 260,000 acres.

3. Union Texas, a division of Allied Chemical Corporation at the time the leases in issue in this case were negotiated, was the company that acquired the leases from Sugg and Farmar.

4. When negotiating an oil and gas lease on behalf of Union Texas, such as the leases acquired from Sugg and Farmar, I am authorized to offer a mineral owner a bonus and a percentage royalty in exchange for the execution of an oil and gas lease. The larger the amount of bonus offered by Union Texas to a mineral owner, the greater likelihood that the mineral owner will accept a smaller percentage share of the production as a royalty. The amount of the bonus offered can be used as a bargaining tool to adjust the mineral owner's percentage share of production offered as royalty.

5. When negotiating the terms of an oil or gas lease, Union Texas recognizes the close interrelationship between bonus and royalty. The royalty and bonus are tied together in the initial negotiations of the oil and gas lease. If a landowner is in poor financial condition and has an immediate need for cash, he will be offered a larger bonus and a smaller royalty percentage as an inducement to sign an oil and gas lease. In addition, Union Texas will offer a mineral owner a greater royalty percentage and little or no bonus as an inducement to execute an oil and gas lease.

6. I have personal knowledge of the facts contained in this affadivit, am of sound mind, am over twenty-one years of age, am fully competent to make this affidavit and make this affidavit in support of the Cross-Motion of the Plaintiffs for Summary Judgment in this case.

/s/ DON DOW

DON DOW

SUBSCRIBED AND SWORN TO before me this 28th day of July, 1981.

/s/ VIRGINIA ANN CURTIS

Notary Public in and for
Midland County, Texas

Supreme Court of the United States

No. 82-774

PHILIP D. FARMAR, ET AL., PETITIONERS,

v.

UNITED STATES

ORDER ALLOWING CERTIORARI. Filed January 10, 1983.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Federal Circuit is granted. The case is consolidated with case No. 82-599, *Commisioner of Internal Revenue* v. *Fred L. Engle, et ux.*, and a total of one hour is allocated for oral argument.